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DE RUEHJA #1755/01 2600802
ZNR UUUUU ZZH
R 160802Z SEP 08
FM AMEMBASSY JAKARTA
TO RUEHC/SECSTATE WASHDC 0106
RUEATRS/DEPT OF TREASURY WASHINGTON DC
INFO RUEHXS/ASSOCIATION OF SOUTHEAST ASIAN NATIONS
RUCPDO/DEPT OF COMMERCE WASHINGTON DC
RUEHRC/DEPT OF AGRICULTURE WASHINGTON DC
RUEHKO/AMEMBASSY TOKYO 2496
RUEHBJ/AMEMBASSY BEIJING 5395
RUEHBY/AMEMBASSY CANBERRA 3037
RUEHUL/AMEMBASSY SEOUL 4910
RUEHGP/AMEMBASSY SINGAPORE 6324
RUEAIIA/CIA WASHDC

UNCLAS SECTION 01 OF 02 JAKARTA 001755

SIPDIS
SENSITIVE

DEPT FOR EAP/MTS AND EB/IFD/OMA
TREASURY FOR IA/MALACHY NUGENT
COMMERCE FOR 4430/KELLY
DEPARTMENT PASS FEDERAL RESERVE SAN FRANCISCO FOR CURRAN
DEPARTMENT PASS EXIM BANK
SINGAPORE FOR SBAKER
TOKYO FOR MGREWE
USDA/FAS/OA YOST, MILLER, JACKSON
USDA/FAS/OCRA CRIKER, HIGGISTON, RADLER
USDA/FAS/OGA CHAUDRY, DWYER
DEPT PASS USTR WEISEL, EHLERS

E.O. 12598: N/A

TAGS: [EFIN](#) [EINV](#) [ECON](#) [EAGR](#) [ID](#)

SUBJECT: [INDONESIAN CURRENCY](#), [MARKETS DROP ON MARKET TURMOIL](#)

REF: Jakarta 1694

[1](#)1. (SBU) Summary. Indonesian financial markets dropped sharply on U.S. financial market uncertainty and falling commodity prices. The Indonesian stock index declined 4.7% on September 15, the sharpest drop in the region. The Rupiah (IDR) has also fallen, moving close to the psychologically important level of IDR/USD 9500 this week. The Government of Indonesia (GOI) announced several measures to address liquidity shortages and calm markets on September 15 and 16. Ongoing uncertainty in global markets and pressure on Indonesia's balance of payments threaten to undermine hard won macroeconomic stability and curb growth. End Summary.

Financial Markets Fall on Uncertainty

[1](#)2. (SBU) Indonesia's financial markets are under heavy pressure due to growing global investor risk aversion created by US financial market turmoil and the decline in global commodity prices. The Jakarta Stock Index (JSX), which is comprised largely of commodity-based companies and financial institutions, declined 4.7% on September 15, the worst decline in the region. The JSX was down an additional 7.0% in early trading on September 16, before recovering those losses toward the end of the day. The index has lost roughly 25% of its value in the month of September. Government bonds have also come under pressure, with the yield on the 5-year government bond increasing 100 basis points from September 5 to September 15. In addition, several recent government bond auctions have failed due to insufficient interest.

[1](#)3. (SBU) Downward pressure on the IDR, which began earlier this month in conjunction with Indonesia's deteriorating trade balance (reftel), accelerated this week in response to financial turmoil in the US. The IDR has traded close to IDR/USD 9500 for the past three trading days, up from 9150 in late August. Bank Indonesia (BI) has intervened heavily in the foreign exchange market in recent days to keep the IDR from exceeding the psychologically important rate of IDR/USD 9500, according to market analysts. Commercial banks have also faced liquidity issues in recent weeks, hiking deposit rates to

attract additional funds.

Indonesian Officials Appeal for Calm

14. (SBU) On September 15, Indonesian officials warned against excessive reaction to market volatility, stressing that Indonesian economic fundamentals remain sound. Officials also outlined a series of actions to improve liquidity. Finance Minister Sri Mulyani Indrawati announced that the government would trim issuance of government bonds by IDR 15 trillion (\$1.6 billion) to ease pressure on markets. She noted that lower oil prices had reduced Indonesia's subsidy bill lowering the projected 2008 budget deficit from 2.1% to 1.7% of GDP. The Finance Minister also stated that the GOI would increase the pace of government expenditures, which have significantly lagged tax collection this year.

15. (SBU) BI also announced several initiatives to calm markets and increase liquidity in the banking sector. On September 16, BI increased the rate it pays commercial banks for deposits held overnight by the central bank by 100 basis points to 8.25% and cut the rate it charges commercial banks for overnight borrowing from the central bank, by 200 basis points to 10.25%. BI adjusted the rates in an effort to reduce the overnight interbank lending rate, which had risen to close to 13% in recent weeks. BI also announced plans to revise several repo market regulations to make it easier for banks to obtain liquidity from BI. BI maintained its overnight policy rate at 9.25% and plans to use open market operations to provide additional liquidity to markets. BI summoned management from the twenty largest banks to appeal to them to stop engaging in "deposit rate wars" which had taken some deposit rates up to

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13.25-14%, according to press reports.

Macroeconomic Vulnerabilities Increase

16. (SBU) Global financial market turmoil and lower commodity prices threaten to undermine macroeconomic stability in Indonesia. Most analysts dismiss the risk of a 1997 style economic crisis given the comparative health of Indonesia's banking system and size of foreign currency reserves, which stood at \$58 billion as of August 31. In addition, foreign ownership of state bonds has not declined sharply in recent weeks, remaining a roughly 20% of total outstanding government bonds. However, pressure on the currency may increase in the coming months if the balance of payments position deteriorates. Market analysts expect Indonesia's trade balance to worsen this quarter due to flagging demand from the US, Japan and Europe and the deterioration of Indonesia's terms of trade. In addition, foreign and domestic portfolio investors may seek a safe-haven in cheaper US stocks and bonds, which carry significantly less country risk, raising the risk of increased capital outflows. [Note: Indonesia's open capital account allows for rapid conversion from IDR to USD assets. End note.]

17. (SBU) The outlook for economic growth this year also continues to weaken, as policy rate hikes appear inevitable. If pressure on the currency increases significantly, the cost of foreign exchange intervention may begin to drain BI's foreign exchange reserves. Some analysts also worry that by setting a clear target for the IDR, BI may actually be increasing pressure on the currency by discouraging currency traders from buying Rupiah. Significant depreciation of the currency could fan inflationary pressures and reduce the benefit of lower world food prices. Some market analysts and the IMF are already calling for additional rate hikes to ensure price stability. While more aggressive monetary tightening will help control inflation, higher interest rates will slow domestic demand as global demand also stagnates, clouding economic growth prospects for the second half of 2008.

HUME